COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN APPLICATION OF EAST KENTUCKY POWER COOPERATIVE, INC. FOR AN ORDER APPROVING THE ESTABLISHMENT OF REGULATORY ASSETS FOR THE DEPRECIATION AND ACCRETION EXPENSES ASSOCIATED WITH ASSET RETIREMENT OBLIGATIONS	)))))	CASE NO. 2014-00432

ORDER

In its March 6, 2015 Order in this matter, the Commission authorized East Kentucky Power Cooperative, Inc. ("EKPC") to establish regulatory assets for the depreciation and accretion expenses in 2014 and subsequent years associated with EKPC's asbestos abatement and ash removal asset retirement obligations ("ARO"), but denied regulatory-asset treatment for expenses associated with the ash transfer costs for the Dale Generating Station ("Dale") Ash Ponds. On March 20, 2015, EKPC filed a petition for rehearing of the Commission's March 6, 2015 Order which requests rehearing of the denial of its request.

EKPC's petition also requests rehearing of ordering paragraph 4 of the March 6, 2015 Order to clarify the filing date of the required annual report for the ARO balances. EKPC also seeks rehearing of ordering paragraph 5 to identify the projects approved in the March 6, 2015 Order and to clarify the reporting thresholds for changes of more than 10 percent of the ARO balances after 2014. EKPC also requests that the Commission clarify the directives of the first paragraph on page 7 and ordering paragraph 5 of the March 6, 2015 Order regarding the amounts and projects approved in the case. Finally, EKPC requests approval to record a credit to expense and debit to the regulatory asset account for $2,149,889 in its 2015 financial statements to bring the regulatory asset balance up to the amount requested in its original application and to also record the entire annual ARO-related depreciation and accretion expenses as regulatory assets in 2015 and subsequent years.[1]

In its April 8, 2015 Order, the Commission granted EKPC's petition for rehearing and established a limited procedural schedule. There are no intervenors in this proceeding. EKPC responded to two requests for information on its rehearing request from Commission Staff ("Staff").

EKPC'S REHEARING REQUEST

In its rehearing request, EKPC argues that the Commission's decision denying regulatory asset treatment for the portion of the ARO-related deprecation and accretion expenses related to the Dale Ash Ponds inappropriately applies the accounting and ratemaking treatments authorized in Case No. 2014-00252[2] for Project No. 15 to the accounting treatment for the previous ARO.[3] EKPC states that it "perceives there may have been a misunderstanding as to the relationship between the AROs and the projects developed to settle those AROs."[4] EKPC points out that AROs are recorded at their present value in the period in which they are incurred and when the amount of the

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[1] *See* EKPC's response to Commission Staff's Second Rehearing Request for Information, dated June 5, 2015, Item 1.

[2] Case No 2014-00252, *Application of East Kentucky Power Cooperative, Inc. for a Certificate of Public Convenience and Necessity for Construction of an Ash Landfill at J. K. Smith Station to Receive Impounded Ash from William C. Dale Station, and for Approval of a Compliance Plan Amendment for Environmental Surcharge Recovery* (Ky. PSC Mar. 6, 2015).

[3] Application for Rehearing at 7.

[4] *Id.* at 5.

liability can be reasonably estimated.[5] In Case No. 2014-00252, the Commission granted EKPC's request for a Certificate of Public Convenience and Necessity to construct the Smith Landfill, but directed EKPC to treat the ash transfer costs from the Dale Ash Ponds for ratemaking purposes as a non-capital expense, with costs being recovered as incurred rather than being capitalized and incurring depreciation and accretion expenses. In its motion for rehearing, EKPC states that either approach results in the full recovery of the ash transfer costs in the future, with the only difference between the two ratemaking treatments being the pace at which those costs are recovered.[6] EKPC emphasized that it does not have any issue with respect to the discretionary ratemaking treatment ordered by the Commission in Case No. 2014-00252.[7] However, EKPC asserts that not being able to record a regulatory asset for the ARO-related depreciation and accretion expenses associated with the ash transfer costs will result in a mismatch in expenses and revenues that will exist on its books for four years, which, consequently, would force EKPC to produce financial statements which tend to understate and then overstate its actual financial performance.[8] EKPC maintains that, "[t]he existence of this mismatch is misleading to the users of EKPC's financial statements, including those institutions that finance EKPC and regulatory agencies, because they will first see a period of depressed margins as ARO expenses are recognized, and later see a period of inflated margins as cost recovery revenues are

[5] *Id.* at 6.

[6] *Id.* at 8.

[7] *Id.*

[8] *Id.* at 2.

recognized."[9] EKPC further states that, "because of the mis-matching of revenue and expenses, a customer or group of customers could file a complaint arguing that EKPC was over-earning when in fact its earnings reflected revenues that recovered expenses from earlier years," which is the situation EKPC had hoped to avoid in its initial request for the regulatory assets.[10]

EKPC also contends that "the accounting treatment prescribed in the March 6, 2015 Order will establish a precedent that is detrimental to EKPC and other Kentucky utilities that will also have to retire significant generation assets in light of new and future environmental regulations."[11] According to EKPC, it desires to maintain consistency between their accounting and ratemaking books.[12] EKPC, therefore, believes that Commission approval of its regulatory asset accounting treatment proposed in its original application and in its rehearing request is necessary to achieve that end.

EKPC is concerned that the March 6, 2015 Order creates an inconsistency with Commission precedent and will complicate the ability of regulated utilities to predict and plan how AROs will be treated for accounting purposes in the future.[13] EKPC points out that the March 6, 2015 Order noted that regulatory assets had been granted by the Commission for AROs on two prior occasions.[14]

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[9] *Id.* at 9.

[10] *Id.*

[11] *Id.* at 2.

[12] *Id.*

[13] *Id.* at 13-14.

[14] *Id.* at 14.

Consistent with the Rural Utilities Service Uniform System of Accounts ("RUS USoA"), EKPC maintains that it recognized the AROs by properly recording capitalized asset retirement costs in its utility plant accounts.[15] The capitalized asset retirement costs are to be depreciated over the useful life of the related asset giving rise to the obligation. In compliance with the RUS USoA, EKPC recorded ARO-related depreciation expense and ARO-related accretion expense totaling $6,352,606 in its 2014 financial statements. As a result of the Commission's March 6, 2015 decision, $2,149,889 of this total 2014 ARO-related depreciation and accretion amounts remained on EKPC's financial statements as an expense and resulted in an equal reduction in its 2014 margins.[16]

EKPC requests clarification of the March 6, 2015 Order as to the filing date of the required annual report for the ARO balances. Ordering paragraph 4 of the Order states "EKPC shall file annually on December 31, based on any new or revised studies or reports, updated ARO calculations by location. The updated calculations shall be submitted at the same time EKPC files its annual report with the Commission." EKPC noted that the ordering paragraph requires filing the same updated ARO calculations on two different dates — December 31 and the date EKPC's annual report is filed with the

[15] *Id.* at 2.

[16] As stated previously, EKPC requests approval to record a credit to expense and debit to the regulatory asset account for $2,149,889 in its 2015 financial statements to bring the regulatory asset balance up to the amount requested in its original application.

Commission, which is March 31.[17] EKPC also noted that the ordering paragraph is not clear as to whether the "updated ARO calculations by location" means the ARO's recorded on EKPC's by type and location as of December 31, 2013, or all ARO's as of the reporting date.[18]

EKPC requests clarification of the directive of the first paragraph on page 7 and ordering paragraph 5 of the March 6, 2015 Order to provide certainty on how to comply with the language contained in those provisions of the Order. Page 7 of the rehearing request discussed a limitation of "projects approved in the instant case" and the monitoring of increases greater than 10 percent in the ARO balances after 2014.[19] EKPC states that ordering paragraph 5 appears to reflect this narrative and states that EKPC shall inform the Commission of any change of more than 10 percent in the ARO balances after 2014.[20] EKPC maintains that the first paragraph on page 7, which states that "amounts should be limited to the projects approved in the instant case," is confusing and appears to be incorrect.[21] EKPC states that it "did not propose or submit a specific project or series of projects associated with the ARO balances as of December 31, 2013 for the Commission's approval in this proceeding. The ARO balances as of December 31, 2013 have been identified as reflecting estimated liabilities for legal obligations associated with the retirement of utility assets related to

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[17] Application for Rehearing at 10.

[18] *Id.*

[19] *Id.*

[20] *Id.*

[21] *Id.* at 11.

asbestos abatement and ash disposal sites by location."[22] EKPC requests the language in the March 6, 2015 Order be revised to delete the reference to approved projects and instead state that expenses afforded regulatory asset treatment in 2014 and subsequent years should be limited to the ARO balances by type and location as of December 31, 2013.[23]

EKPC believes the language in the first paragraph on page 7 is also inconsistent with another portion of the Commission's March 6, 2015 Order. EKPC had requested that the Commission reclassify the 2014 ARO-related depreciation and accretion expense as regulatory assets and that all subsequent ARO-related depreciation and accretion expenses associated with the ARO balances by type and location on December 31, 2013 be recorded as regulatory assets.[24] On page 6 of the March 6, 2015 Order, the Commission found that, with the exception of the depreciation and accretion expenses associated with the ash transfer costs, the proposed regulatory assets should be approved. However, EKPC points out that in the first paragraph on page 7 of the March 6, 2015 Order, the Commission stated:

> While the Commission is hereby granting approval for depreciation and accretion expenses as regulatory assets in 2014 and subsequent years, those amounts should be limited to the projects approved in the instant case. Furthermore, the Commission should be informed of any increase of more than 10 percent in the ARO balances after 2014 to determine whether a formal proceeding may be necessary to address such changes. If future ARO balances increase by more than 10 percent, EKPC must file for supplemental authority to record the excess amounts in the ARO-related depreciation and accretion expenses.

[22] *Id.*

[23] *Id.*

[24] *Id.*

EKPC maintains that an inconsistency exists because the Commission appears to approve EKPC's request to reclassify as regulatory assets the 2014 ARO-related depreciation and accretion expenses and all subsequent ARO-related depreciation and accretion expenses associated with the ARO balances by type and location on December 31, 2013, yet then states if the ARO balances after 2014 increase by more than 10 percent, there may be a need for further formal proceedings and that EKPC must file for supplemental authority to record the "excess amounts" in the ARO-related depreciation and accretion expenses.[25] EKPC also believes the last two sentences in the first paragraph on page 7 are in conflict, stating, "The first of the two sentences indicates that if there has been an increase of more than 10 percent in the ARO balances after 2014, a determination will be needed as to whether a formal proceeding may be necessary to address the changes. Yet the second of the two sentences directs that if the increase is more than 10 percent, EKPC must file for supplemental authority to record the excess amounts in the ARO-related depreciation and accretion expenses. Using the same threshold, one sentence indicates it will have to be determined if a formal proceeding is needed and the other sentence requires the filing of a formal pleading."[26]

EKPC has concerns about the 10 percent threshold. It states that "if the 10 percent threshold were applied to the ARO balances as of December 31, 2013, this would mean any increases greater than $3,223,803 would require Commission notification. The ARO balances recorded by EKPC as of December 31, 2014 total

[25] *Id.* at 12.

[26] *Id.*

$33,263,092, making the reporting threshold $3,326,309. Regardless of which balance is utilized, a threshold for this type of reporting in the $3,000,000 range would appear to be unnecessarily restrictive."[27]

A related concern of EKPC is whether the 10 percent threshold is applied to changes from year to year or cumulative since 2014. EKPC notes that if the application is to be cumulative since 2014, it is very possible that the normal accretion activity could result in ARO liability balances that exceed the 10 percent threshold within a few years.[28] It also notes that while the first paragraph on page 7 of the March 6, 2015 Order refers to "*increases* in the ARO balances after 2014 of more than 10 percent," ordering paragraph 5 refers to "*any change* of more than 10 percent in the ARO balances after 2014." [Emphasis by EKPC.] EKPC suggests with its rehearing request that the provision of annual updated ARO calculations by location will provide the Commission with essentially the same information concerning changes in the ARO balances as would be disclosed using the 10 percent threshold.[29]

EKPC reiterates that it understands that separate applications for regulatory asset treatment would be required for any other types of AROs or any other locations identified after the date of the initial application in this proceeding.[30]

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[27] *Id*. at 12-13.

[28] *Id*. at 13.

[29] *Id*.

[30] *Id*.

DISCUSSION

The Commission has previously approved regulatory assets for jurisdictional utilities[31] when a utility has incurred: (a) an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning; (b) an expense resulting from a statutory or administrative directive; (c) an expense in relation to an industry sponsored initiative; or (d) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the cost.[32] EKPC believes its request to establish regulatory assets for the ARO-related depreciation and accretion expenses is consistent with the second listed example, as the ARO-related depreciation and accretion expenses result from the accounting requirements of the RUS USoA and ASC Topic 410-20.[33]

In response to Item 1 of Staff's First Rehearing Request for Information, EKPC provided an explanation, along with authoritative literature and examples, as to why the accounting treatment of the ARO-related depreciation and accretion expenses should

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[31] The Commission approved the establishment of regulatory assets for ARO-related depreciation and accretion expenses in Case No. 2003-00426, *Application of Louisville Gas and Electric Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003* (Ky. PSC Dec. 23, 2003) and Case No. 2003-00427, *Application of Kentucky Utilities Company for an Order Approving an Accounting Adjustment to be Included in Earnings Sharing Mechanism Calculations for 2003* (Ky. PSC Dec. 23, 2003) when Louisville Gas and Electric Company and Kentucky Utilities Company adopted Statement of Financial Standards No. 143, *Accounting for Asset Retirement Obligations.*

[32] *See* Case No. 2008-00436, *The Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages* (Ky. PSC, Dec. 23, 2008), Order at 4. *See also* Case No. 2010-00449, *Application of East Kentucky Power Cooperative, Inc. for an Order Approving the Establishment of a Regulatory Asset for the Amount Expended on Its Smith 1 Generating Unit* (Ky. PSC Feb. 28, 2011), Order at 7.

[33] Application at 6.

be separate from the ratemaking treatments authorized by the Commission in Case No. 2014-00252. The authoritative literature included the following:

- RUS USoA – Section 1767.15 – Accounting for Asset Retirement Obligations
- RUS USoA – Section 1767.10 – Definitions, Regulatory Assets and Liabilities
- Accounting Standards Codification ("ASC") Topic 410-25-2 – Costs from Asset Retirement Obligations
- ASC Topic 410-20-35 – Asset Retirement Obligations, Subsequent Measurement

Upon review of this information, the Commission has concluded that the accounting for ARO liabilities, corresponding capitalized asset retirement costs, and ARO related depreciation and accretion expenses constitute a set of transactions that are distinct and separate from the ratemaking treatment authorized in Case No. 2014-00252. As such, EKPC's request in this case "to defer and record all ARO-related depreciation and accretion expenses as a regulatory asset would allow it to properly match these expenses with the [revenue] recovery of the actual costs incurred to settle the ARO, regardless of the recovery period."[34] The Commission agrees that the proposed accounting treatment will eliminate the mismatch of revenues and expenses associated with ash transfer costs and the resulting financial statement impacts.

In response to Staff's Second Rehearing Data Request, EKPC provided an example of the accounting treatment of the ARO-related depreciation expenses

[34] Application for Rehearing at 8.

associated with the ash transfer costs using actual costs. Upon review of this information, the Commission finds that the ratemaking treatment required for the ash transfer costs for the environmental plan in Case No. 2014-00252 need not be consistent with the accounting treatment for the AROs. The Commission finds that EKPC should be allowed to have separate and distinct accounting treatment in this case for the ARO-related depreciation and accretion expenses related to the ash transfer costs associated with the ARO balances by type and location on December 31, 2013.

The Commission also finds that EKPC's proposed accounting treatment is in conformity with all applicable accounting principles and KRS 278.220. Finally, the Commission finds reasonable EKPC's request to allow it to record a credit to expense and debit to the regulatory asset account for $2,149,889 in its 2015 financial statements to bring the regulatory asset balance up to the amount requested in its application and to also record the entire annual ARO-related depreciation and accretion expenses as regulatory assets in 2015 and subsequent years

The Commission agrees with EKPC's request to revise ordering paragraph 4 of the March 6, 2015 Order to clarify the filing date of the ARO annual report. Ordering paragraph 5 will be eliminated, which eliminates any thresholds, as there will be annual reports filed for the AROs upon which the Commission, if necessary, could initiate a review of the changes contained in the annual report.

Finally, the Commission agrees with EKPC's proposed changes to page 7 of the March 6, 2015 Order in that the amounts and projects approved in this case should be limited to the ARO balances by type and location as of December 31, 2013. The final two sentences of the paragraph will be eliminated.

IT IS THEREFORE ORDERED that:

1. The accounting treatment requested by EKPC to classify depreciation and accretion expense related to its ash transfer costs as regulatory assets is approved for 2015 and subsequent years.

2. EKPC's request to record a credit to expense and debit to the regulatory asset account for $2,149,889 in its 2015 financial statements to bring the regulatory asset balance up to the amount requested in its original application is approved.

3. The regulatory asset and liability accounts established in this case are for accounting purposes only.

4. EKPC shall, within 14 days of the date of this Order, file with the Commission the accounting entries made on its books to effectuate the creation of the regulatory assets as approved herein.

5. EKPC shall file annually updated ARO calculations reflecting any studies, reports, or change in other assumptions for the ARO balances by type and location as originally recorded at December 31, 2013. The annual update shall be based upon the balances of December 31 of each year and the updated calculations shall be submitted at the time EKPC files its annual report with the Commission.

6. Ordering paragraph 5 to the Commission's March 6, 2015 Order in this matter is stricken.

7. All other provisions of the Commission's March 6, 2015 Order not addressed herein shall remain in full force and effect.

8. Any document filed in the future pursuant to ordering paragraphs 4 and 5 herein shall reference this case number and shall be retained in the utility's general correspondence file.

By the Commission

ENTERED

JUL 21 2015

KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

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